

**TAXPAYERS' BILL OF RIGHTS HEARING
FRANCHISE TAX BOARD
MINUTES
DECEMBER 16, 1999**

The Franchise Tax Board met in open session at 10:00 a.m. at the State Board of Equalization, 450 N Street, Hearing Room 121, Sacramento, California. Present were Hon. Kathleen Connell, Hon. Johan Klehs, and Hon. B. Timothy Gage.

Franchise Tax Board

Staff Participating:

Gerald Goldberg, Brian Toman, Johnnie Lou Rosas, Anne Smith, Ben Miller, Janet Ballou, Larry Counts, Jim Shepherd, and Katie Horn.

Others Participating:

Richard Harris representing himself, Albert Shifberg representing California Society of Enrolled Agents, Tim Hayes representing Deloitte & Touche, Jess Penilla representing Deloitte & Touche, Dave Doerr representing Cal-Tax, Gina Rodriguez representing Spidell Publishing, Carl Lonton representing National Association of Lottery Purchasers, Michael Damore representing Woodbridge-Sterling, Vic Ioppolo representing California Senior Legislature, John Kehoe representing Commission on Aging, Rich Glover representing himself, Lenny Goldberg representing Privacy Rights Clearinghouse.

Item 2. - Taxpayers' Bill of Rights Hearing

Chair Connell read the opening statement as required by law, and introduced Franchise Tax Board staff members who were present and able to respond to questions.

Richard E. V. Harris, Representing Himself

Transparency. Mr. Harris stated that transparency, which he defined as the ability of people outside to see what is going on inside the Franchise Tax Board, is important to the efficiency of tax administration in California because when people are given information about what it is going on, they are more likely to feel that they have been treated fairly.

Improvements to FTB's Internal and External Communications Programs. Mr. Harris requested that the Franchise Tax Board post its roster of litigation on the FTB website. Mr. Harris also asked that FTB identify and make available, preferably by hyperlink, rulings and decisions in all litigation matters identified in the litigation roster on its website.

California Public Records Act. Mr. Harris expressed his belief that the Franchise Tax Board is not complying in a timely manner with his requests for information being made under the California Public Records Act.

Brian Toman, Chief Counsel, explained that the FTB is complying with the California Public Records Act, but that staffing and resource issues have arisen because of the increasing volume of these requests. Further, Mr. Toman emphasized that many delays are

caused by the time-consuming necessity to redact confidential taxpayer information to protect taxpayers' rights to privacy. Mr. Toman indicated that staff has recently instituted a tracking system to allow staff to keep closer track of how long a request has been in-house and how quickly staff can respond to it.

Chair Connell asked Mr. Toman to report back to the Board on where improvements to the system might be made, and to consult with staff at the Board of Equalization as to how they respond to such requests.

MTC. Mr. Harris stated that the MTC had adopted a very aggressive nexus program, and that two or three years ago FTB formally pulled out of this program. Mr. Harris wanted to know why the FTB is listed on the MTC website as a member of its National Nexus Program.

Mr. Goldberg explained that we remain participants in the nexus program, but not all members of the MTC Nexus program have the same nexus policies. The reason the FTB is a member is because it gets valuable information with regard to various taxpayers and their possible activity in California. Thus, California is properly listed on the MTC website. Mr. Goldberg also explained that the MTC does not adopt California regulations, nor do they pass California legislation, but that instead this is the responsibility of the Franchise Tax Board, Board of Equalization, or the California Legislature. Mr. Goldberg stated that he hoped that taxpayers would see that we are a part of the program, but not necessarily that all members who participate in the program have the same regulations and laws.

Member Gage asked Mr. Goldberg if it would be appropriate to suggest to the MTC that they note on their website that there are varying standards.

Mr. Goldberg agreed to communicate this to the MTC.

Congressional Investigation of Alleged Abuses by State Taxing Authorities. Mr. Harris identified an item published in the federal Congressional Record on August 5, 1999, regarding Congressman Weller's statement relating to a California tax matter that Mr. Goldberg told the Board was currently in litigation. Mr. Goldberg further told the Board that he was aware of the case, but since the matter was currently in litigation, it was not appropriate for him to discuss it in further detail.

Principles of Tax Administration. Mr. Harris told the Board that two years ago when the Board adopted the Principles of Tax Administration, that there was also a direction that it be included in all FTB manuals. Mr. Harris told the Board that while it has been included in certain publications, it does not appear to be included in all FTB manuals.

Mr. Goldberg said that he thought it was already in the manuals, but that staff will check on it.

Albert Shifberg, Representing the California Society of Enrolled Agents

Client Privilege. Mr. Shifberg stated that a federal law was passed in 1998 that granted taxpayers a limited privilege when dealing with tax practitioners covered under Circular

230 of the Code of Federal Regulations. He stated that the federal legislation does not cover conversations dealing with the preparation of income tax returns or criminal matters, but it does cover administrative matters and court appearances. Mr. Shifberg expressed his concern that pending legislation drafted by Assembly Member Briggs, AB 1016, deals only with administrative matters, so that if California does not have conformity at the state level to the federal legislation, the taxpayer in effect has no privilege at all, even at the federal level, because of the exchange of information agreements between IRS and FTB.

Johnnie Lou Rosas informed the Board that the bill is in the Senate Revenue and Taxation Committee, that it was defeated on its first hearing but was granted reconsideration, and that the bill actually has all year to get out of the Senate.

Net Operating Loss Conformity and Corporate Dissolution Simplification. Mr. Shifberg submitted written testimony on the issues of net operating loss conformity and corporate dissolution simplification.

Johnnie Lou Rosas informed the Board that she has not seen any legislation on the net operating loss issue, but that it is out there as a legislative issue for this year and that she expected to see it in a bill this year.

Chair Connell asked Ms. Rosas to keep the Board advised on this issue.

Nanny Tax. Mr. Shifberg [returning to address the Board at a later point in the hearing] told the Board that the California Society of Enrolled Agents has been working for some time with the California Society of CPAs with respect to the federal legislation referred to by Ms. Rodriguez in her testimony. He stated that they would also be happy to support the Board in sponsoring a bill at the state level.

Jess Penilla & Tim Hayes, Representing Deloitte & Touche Multi-State Tax Services Group.

Protest Process – Roll of the Hearing Officer in Oral Hearings. Mr. Penilla and Mr. Hayes stated that they believe the protest process is frustrating and that the role of the hearing officer in an oral hearing and the protest process in general is unclear. Mr. Penilla said that hearing officers will routinely request additional new information that would support the auditor's position, and that they will also raise entirely new positions and issues that might support the audit adjustments, thereby in effect re-auditing the taxpayer.

Brian Toman explained that, whenever new issues are raised either by the taxpayer or by Franchise Tax Board staff, then staff must gather the information relevant to that new issue. Mr. Toman also explained that in many circumstances the problem is that because of an impending expiration of the statute of limitations, an audit case isn't as well developed as it could be, and some taxpayers decline to grant waivers of the statute of limitations to the auditor. He also stated that, at the direction of the 1998 Board, Franchise Tax Board staff is currently developing a new protest hearing and procedure regulation with the ultimate goal of shortening the amount of time taken to complete the entire protest process.

Mr. Toman informed the Board that staff will be doing a symposium on this proposed protest regulation and will be reporting back to the Board.

David Doerr, Representing Cal-Tax

Double Taxation. Mr. Doerr suggested legislation that would provide a credit against the bank tax later paid by financial institutions that find themselves in the situation where they are being double taxed, paying local property taxes and business license tax, and then, after the statute of limitations for filing a claim for refund of the local property taxes and business license tax has expired, are audited by the Franchise Tax Board and classified as a financial corporation subject to the bank tax rate.

Refund Issues on an Audit. Mr. Doerr suggested that the Board adopt a procedure that ensures that staff is pursuing refund issues on an audit, such as having the Executive Officer send a memo to each auditor instructing him or her that they are to pursue refund issues. Then this memo would be handed to the taxpayer at the time of the audit, with a customer satisfaction survey conducted after completion of the audit, with the results sent to the Taxpayers' Advocate's Office and reported periodically to the Board.

Symposiums on Regulations. Mr. Doerr acknowledged that the Board has stated it favors having symposiums on regulations and urged that all regulations have a symposium.

Unitary Theory. Mr. Doerr stated that the way a company is organized shouldn't make a difference in its tax liability, whether it operates by divisions or by separate subsidiaries. He thinks that the Board should be following unitary theory, particularly as it relates to the utilization of credits by members of a unitary group.

Consolidated Returns Bill. Mr. Doerr urged the Board to support the Consolidated Returns Bill without an amendment.

"Pay-to-Play". Mr. Doerr asked the Board to support the bill which would permit taxpayers to challenge proposed assessments of additional tax in California courts without having to pay the tax first, similar to that permitted in other states such as Massachusetts.

Net Operating Loss Carryforwards. Mr. Doerr urged the Board to support net operating loss carryforwards.

Foreign Income. Mr. Doerr suggested that foreign income should not be taxed, specifically foreign-source dividends.

Manufacturers' Investment Credit (MIC). Mr. Doerr stated that taxpayers claiming the MIC are being targeted with audits and this is sending a bad message to taxpayers. He suggests that the Board of Equalization's audit results should be accepted with respect to the issue of establishing payment of the sales or use tax on property qualifying for the MIC. Mr. Doerr further suggested that the MIC should be increased from the current 6 percent rate to a rate equal to the sales tax rate and that the carryforward period for unused MIC credits should be extended to 15 years.

Mr. Goldberg will review Mr. Doerr's proposals and report back to the Board.

Gina Rodriguez, Representing Spidell Publishing

Nanny Tax. Ms. Rodriguez reported that HR 1180 was on President Clinton's desk, and that she expected he would be signing it the following day. HR 1180 authorizes all states to allow annual wage reporting for household employers. Ms. Rodriguez stated that according to EDD, the enactment of HR 1180 means that California could allow employers to report wages and pay the employment taxes with the personal income tax returns, which EDD was estimating could occur as soon as the 2002 filing season. However, Ms. Rodriguez stated that a lot of coordination between FTB and EDD needs to take place.

Ms. Rodriguez explained that she works closely with the EDD, and that they do not have a director. Consequently, she believes they feel their hands are tied with respect to any new program issue.

Chair Connell stated that she would sponsor legislation and get someone to be the author of legislation this year.

Lottery Winnings. Ms. Rodriguez stated that practitioners are still waiting for guidance from the FTB on the issue of lottery winnings, and she recommends that the Board support the publication of a legal ruling on how taxpayers are to handle these issues.

Alternative Minimum Tax Income Exclusion (AMTI). Ms. Rodriguez reported that the computerized tax developers who develop tax software programs are waiting for a response from the FTB on how to handle AMTI calculations with relation to carryover items. She recommended that staff immediately and publicly provide guidance to these software developers so that affected taxpayers are not subject to an auditor's interpretation of how to handle these transactions.

S Corporation Shareholders and AMT Credit for Corporations. Ms. Rodriguez did not present her last two issues (S Corporation shareholders and AMT credit for corporations) but urged the staff to look at her recommendations and recommend that the Board sponsor legislation as staff deems appropriate.

Carl Lonton, Representing the National Association of Lottery Purchasers

Lottery. Mr. Lonton pointed out that the assignment (the process of a company buying out a piece or all of the annualized prize payments of a lottery winner) of lottery winnings has been allowed in California since 1994. Mr. Lonton recommended that the Board reject the proposed legal ruling concluding that the assignment of lottery winnings in exchange for a lump-sum payment would be taxable. Mr. Lonton further suggested that the Board consider pursuing legislation that would make taxability of the assignment transaction consistent with the California taxation of the prize winnings absent an assignment transaction.

Member Klehs explained that the Board had two options. One option would be not to implement the draft ruling, because it says the assignments would be taxable, which is

against the spirit of the lottery. The other would be that Johnnie Lou Rosas have staff prepare clarifying legislation. Member Klehs stated that he had already talked to Senator Don Perata and that the Senator would be very interested in sponsoring legislation or carrying legislation that the two tax agencies could sponsor.

Michael Damore, Representing Woodbridge-Sterling

Lottery. Mr. Damore explained that about 20 percent of the people who have annualized prizes do something with those prizes. Most people sell four or five payments, parts of three payments, etc., rather than the entire annuitized stream of payments. Mr. Damore also reported that approximately 70 percent of the people take the lump sum option now provided by the Lottery Commission. Mr. Damore further stated that since 1994, approximately over a thousand winners have done this type of assignment transaction, and would now be looking at a very unpleasant tax bill, should the draft legal ruling be adopted.

The Board informed Mr. Damore that they were convinced.

Mr. Toman informed the Board that staff, acting in its own discretion, would withhold issuing the legal ruling. He also stated that staff understood the Board's wishes regarding obtaining clarifying legislation.

John Kehoe, Representing the California Commission on Aging

Mr. Kehoe requested that the FTB implement a BCP to have a mailing go out to people who no longer use line 49 on their tax return to donate to the California Commission on Aging. Discussion followed regarding the pros and cons of such an action, with Mr. Goldberg agreeing to provide the Board with a cost estimate of doing the mailing.

Vic Ioppolo, Representing the Joint Rules Committee of the California Senior Legislature

Mr. Ioppolo told the Board that his organization represents four million seniors in the State of California, and that the mailing discussed by Mr. Kehoe regarding past contributors on line 49 is something they really need to have. Mr. Ioppolo also presented the Board with a copy of their "Top Ten State and Top Four Federal Legislative Proposals." Mr. Ioppolo stated that he was there so that hopefully the Board would consider what Mr. Kehoe presented to them.

Rich Glover

Garnishments. Mr. Glover requested that the Franchise Tax Board provide periodic statements to people who have garnishments, reporting the total amount of taxes garnished during that year.

Mr. Goldberg told the Board that staff would take a look at this area and get back to the Board with regard to current departmental practices.

Privacy Issues. Mr. Glover explained problems he was having preparing a “married, filing separate” return as a result of privacy issues between non-communicative and non-cooperative spouses and community property laws that require the division of the community income between the spouses on a married, filing separate, return.

Mr. Toman explained that a tax agency is in a very difficult position when spouses aren’t able to talk to each other, and yet one spouse is looking to the tax agency to provide the information that the other spouse doesn’t want to provide to assist in preparation of the tax return.

Americans with Disabilities. Mr. Glover stated that for taxpayers with mental disabilities, the IRS will make accommodations if you are late in filing your returns but the state will not.

Chair Connell explained that the state does have a process. She urged taxpayers, if they feel they are under either emotional or financial distress, to call and talk to a Franchise Tax Board counselor.

Anne Smith from the Franchise Tax Board’s Advocate’s Office stated that if a taxpayer has been hospitalized, there are provisions that would alleviate some of the penalties. Ms. Smith stated that she would be happy to talk with Mr. Glover about his specific situation.

Mr. Glover stated that the state requires him to have a 1040 when he files with the state, but the IRS has given him an extension, so the state requirement is unreasonable.

Jim Shepherd from FTB’s Public Affairs Office explained that everyone currently is entitled to an automatic six-month extension of time to file.

Lenny Goldberg, Representing California Tax Reform Association and Privacy Rights Clearinghouse

Privacy Issues. Mr. Lenny Goldberg stated that legislation may be necessary to ensure privacy in the context of the sharing among affiliates of data and other information provided to a tax preparer that is part of a consolidated financial services organization. Mr. Lenny Goldberg further stated that he believes that the law is inadequate with regard to privacy concerning the information (tax returns) people are required to give to financial institutions in order to apply for or refinance a mortgage. Mr. Lenny Goldberg stated that they would look for the Board’s support of any potential legislation that would require that these records be destroyed after a specified period of time. To give any such potential legislation the requisite enforceability, it might specify significant penalties for the use of any financial data that is provided by means of a tax return.

Chair Connell told Mr. Lenny Goldberg that she would like to work with him on these privacy issues.

The meeting was adjourned at 11:55 a.m.

Board Secretary

Date